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Report to the Chairman, Legislation and
National Security Subcommittee,
Committee on Government Operations,
House of Representatives



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May 1987

INTERNAL CONTROLS

Defense Fuel Supply Center's Recording and Reporting of Accounts Payable



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United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

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May 13, 1987

The Honorable Jack Brooks
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This is a response to your June 23, 1986, request that we evaluate the Defense Fuel Supply Center's (DFSC) financial and management information systems used to control, account for, and report on its bulk petroleum program. Based on agreements with your office, our review focused on system weaknesses in DFSC's controls for recording and reporting accounts payable.

DFSC, one of six Defense Logistics Agency (DLA) supply centers, is responsible for procuring, stocking, and distributing petroleum commodities it sells to the Department of Defense and other federal agencies. During fiscal year 1986, DFSC purchased over \$4.3 billion in fuels and, as of September 30, 1986, had over 17,500 accounts payable balances, totaling about \$416 million, resulting from fuel purchases.

We found that DFSC does not have adequate controls to ensure the proper recording and reporting of millions of dollars of accounts payable resulting from its fuel purchases. Reviews of accounts payable balances, conducted by both DFSC and us, indicate that DFSC's accounting system is inaccurately reporting amounts owed contractors. For example, DFSC's accounting system showed a \$6.2 million accounts payable balance for six accounts we reviewed when the correct balance should have been only \$2.5 million.

Although DFSC is required to conduct periodic reviews of accounts payable balances to ensure that the balances are paid or to adjust the balances to reflect the correct amount of payables, we found DFSC's reviews were not adequate. As a result, DFSC does not know if accounts payable balances that have remained outstanding for long periods are correct. As of September 30, 1986, over 7,800 of DFSC's 17,500 accounts payable balances (or about 45 percent) had been outstanding for over 180 days.

We also found that overpayments DFSC made to contractors were not being properly classified, reported, or collected. These overpayments are

being improperly recorded and reported as negative accounts payable rather than accounts receivable, thereby understating both balances. In addition, classifying overpayments in this manner causes management to lose visibility over collections. As of September 30, 1986, for example, over \$46 million of potential overpayments were recorded as negative accounts payable.

DFSC recognizes that there are problems with the recording and processing of accounts payable information and it plans to comprehensively review recorded accounts payable to identify and correct inaccurate balances.

We are making several recommendations which, if properly implemented, would strengthen internal controls and help ensure that (1) accounts payable balances are recorded and reported promptly and correctly and (2) overpayments to contractors are properly classified, reported, and collected.

A discussion of accounts payable weaknesses and the details of our work follow.

Background

The Defense Logistics Agency, created in 1961, is charged with providing effective and economical support to the U.S. military services and other agencies for certain supply items or technical and logistics services. DLA's primary activities include (1) procuring, stocking, and distributing materiel, (2) administering and making payments on government contracts, and (3) providing other worldwide support services, including property reuse and disposal, cataloging of supply items, and management of defense industrial property.

Supply support functions are carried out by six DLA supply centers. The centers buy supplies from commercial sources and sell them to DLA customers at the purchase price plus a surcharge to cover certain operating expenses. DFSC, the center responsible for bulk petroleum commodities, is located at Cameron Station in Alexandria, Virginia. DFSC has 10 regional offices which control and report to headquarters on fuel receipts, storage, and distribution at 213 defense fuel supply points located worldwide. During fiscal year 1986, DFSC reported fuel purchases and sales of \$4.3 and \$6.3 billion respectively.

To better control and account for its fuel operations, DFSC, in 1982, implemented the Defense Fuel Automated Management System (DFAMS).

The system was designed to account for and provide management information for DFSC transactions related to the purchase and sale of fuels but not to handle disbursements. Disbursements are handled by DLA's Administrative Support Center.

As a result of a DLA evaluation of DFAMS in June 1986, DLA reported in its 1986 annual Financial Integrity Act report¹ that DFAMS did not conform to the Comptroller General's accounting principles and standards. DLA's report stated that DFAMS had not been implemented with a general ledger control structure as required by the principles and standards to provide the discipline needed in a basic accounting system. DLA stated that an action plan was being developed to correct the deficiencies and that DFAMS would be brought into compliance with the Comptroller General principles and standards during fiscal year 1987.

Objective, Scope, and Methodology

The primary objective of our review was to assess the adequacy of DFSC's financial management system in controlling, accounting for, and reporting on its fuel program. We concentrated on determining the adequacy of controls over the recording and reporting of DFSC's accounts payable. We conducted audit work at the DFSC headquarters, DLA, and DLA's Administrative Support Center, all located at Cameron Station. At these locations, we met with responsible officials, reviewed pertinent accounting regulations, policies, accounting reports, and internal studies and evaluations.

To accomplish our objective, we examined DFSC's procedures for recording, controlling, and reporting accounts payable balances. This included reviewing accounts payable reports and supporting records to determine if amounts were recorded properly and promptly. To assess the adequacy of accounts payable reviews performed by DFSC, we noted the length of time accounts payable balances remained outstanding.

We judgmentally selected 20 accounts payable balances from over 20,000 balances recorded as of August 31, 1986, to determine if the recorded amounts were valid accounts payable balances. The 20 balances were selected based on such factors as (1) the large dollar value of the balance, (2) the amount of time the balance had been outstanding, and (3) an indication that the balance may not be accurate (for example,

¹The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b) and (c)) requires heads of federal agencies to report annually on whether the agency accounting systems conform to the Comptroller General's accounting requirements.

the balance showed a positive quantity of fuel being delivered but had a negative accounts payable balance).

To determine the accuracy of these 20 balances, we reconstructed the balances by reviewing source documents such as receiving and acceptance reports, contract pricing information, and payment vouchers. We compared our reconstructed balance with the recorded balance and attempted to determine the reason for any differences. In addition to our sample, we examined the results of a joint DFSC and Administrative Support Center task force which reviewed 300 balances.

As you requested, we did not obtain agency comments on a draft of this report. Except for that, our review was conducted in accordance with generally accepted government auditing standards. The review was performed between August and December 1986.

Amounts Owed DFSC Contractors Are Inaccurately Reported

Information essential to determining the proper amount DFSC owes contractors is not being properly entered in or processed by DFAMS. As a result, DFAMS is inaccurately reporting amounts owed DFSC contractors. DFSC is in the process of determining why accounts payable data were not being properly recorded and processed. The amounts DFSC owes contractors for fuel purchases are determined by the quantity of fuel delivered, the date delivered, and the contract price. This information must be recorded and processed accurately and promptly to ensure account balances are accurate and current.

Further, many account balances are subject to retroactive price adjustments made 2 or 3 months after the initial accounts payable balances have been paid. Since these price adjustments result in contractor over/underpayments, the adjustments must also be recorded and processed accurately and promptly.

We found that 11 of the 20 accounts payable balances that we reviewed were inaccurate. Included in the 11 incorrect balances were 5 balances with negative values totaling \$3.9 million which, if accurate, would have represented overpayments to the contractor. However, our review showed that no amounts were due from the contractors and that no balances should have been recorded for any of the 5 balances. The other 6 incorrect balances had a total recorded value of \$6.2 million when the correct total balance should have been only \$2.5 million.

We found that the inaccurate balances occurred because information essential to computing the balance properly had either not been recorded in DFAMS or had not been properly processed by the system. For example, while one balance showed a \$148,840 negative accounts payable, our analysis of the account showed that a 1984 price adjustment, which would have reduced the balance to zero, was not recorded in DFAMS. A DFSC official, responsible for reviewing accounts payable, agreed that the recorded balance was inaccurate but could not provide us with a specific cause for why the adjustment had not been recorded.

In another instance, although the correct price information had been entered into DFAMS, the system did not properly process the information. In this case, DFSC adjusted the quantity of fuel received, which should have reduced the accounts payable by 36 cents. However, DFAMS erroneously repriced the fuel, thereby reporting a negative accounts payable amount of \$601,000, when the correct balance should have been zero. DFSC officials acknowledged that this error was a computer system programming deficiency and has initiated actions to correct it.

A subsequent review performed by DFSC and the Administrative Support Center of 300 accounts payable balances, with negative values totaling over \$7.6 million, disclosed that 160 of these balances, totaling \$4.2 million, were inaccurate. This review also found that the inaccuracies were occurring because DFAMS was not correctly processing price adjustments and/or price adjustment data were not being input into DFAMS. The review also disclosed that other payable information such as delivery dates, fuel quantities, and additional delivery charges—information critical to accurately calculating accounts payable balances—was not being entered correctly.

DFSC recognizes that there are problems with the recording and processing of accounts payable information and that the extent of accounts payable inaccuracies is still undetermined. Subsequent to our review of balances, DFSC established a task force to help identify the reasons for such errors and correct inaccurate balances. DFSC officials also informed us that they are considering alternatives such as hiring additional personnel or a contractor to comprehensively review accounts payable balances to identify and correct inaccurate balances.

Reviews of Aged Accounts Payable Balances Are Not Adequate

Periodic reviews of accounts payable balances are essential to ensure that the balances are paid promptly, amounts are recorded correctly, and sufficient evidence exists to support the balances. DFSC, however, was not performing adequate reviews of accounts payable balances. As a result, DFSC does not know if balances that have remained outstanding for long periods have been recorded correctly or paid.

DLA regulations prescribe policies and procedures that DFSC must follow for reviewing and resolving unpaid accounts payable balances. Generally, the regulations require DFSC to review balances that remain unpaid for over 30 days to determine what actions are required to liquidate the balances, for example, paying off the remaining balance or adjusting the balances to reflect the correct amount of the payables. In addition, the regulations also require DFSC to continually review accounts payable to (1) ensure the accuracy and completeness of recorded balances and (2) detect system deficiencies.

We found, however, that DFSC had large numbers of balances that had been outstanding for long periods. For example, our analysis of a DFSC monthly report containing accounts payable balances showed that as of September 30, 1986, over 7,800 of DFSC's 17,500 account balances (or about 45 percent) had been outstanding for over 180 days. Of these 7,800 balances, 2,700 were more than 360 days old.

DFSC officials responsible for conducting reviews of aged accounts payable balances told us that they do not have sufficient resources to conduct the required reviews. These officials said that they try to concentrate their review efforts on larger dollar balances and lesser amounts that have been outstanding for over 180 days.

DFSC officials did not prepare a study showing what staffing is required and what is available to conduct the reviews required by their regulations. We believe such a study should be prepared showing the staff needed for the continuing reviews required by regulations. If the study fully supports the DFSC officials' contention that sufficient resources are not available, then the study should provide alternatives for complying with requirements. For example, one alternative might be to hire additional staff to perform the reviews. Another alternative could be to hire a contractor to perform a one-time comprehensive review of accounts payable balances. The purpose of this would be to reduce the backlog of accounts payable to a manageable level.

Contractor Overpayments Are Not Being Properly Reported and Collected

Department of Defense regulations require that the occurrence of any event that results in money owed to the U.S. Government be promptly recorded as an accounts receivable upon completion of the act that entitles DOD to collect amounts owed it. By including and reporting negative amounts, representing potential accounts receivable, in its accounts payable, DFSC is not adhering to this requirement. As a result, DFSC's financial presentation of its accounts payable and receivables is distorted and contractor overpayments are not being promptly detected and collected.

Many of DFSC's accounts payable balances are caused by retroactive price adjustments authorized by the contracts. These adjustments occur 2 or 3 months after initial payment has been made to the contractor. During periods of rising fuel prices, the adjustments normally result in the contractor having been underpaid because the initial price was lower than the final adjusted price. Conversely, during periods of falling fuel prices, the adjustments normally result in the contractor having been overpaid because the price paid was higher than the final adjusted price.

Rather than establishing an accounts receivable balance for these overpayments, as required by DOD regulations, DFSC records the overpayment as a negative accounts payable in anticipation of offsetting the negative amount against any subsequent payments to the contractors. For example, our analysis of a DFSC monthly report shows that nearly 7,500 of the 17,500 accounts payable balances as of September 30, 1986, were recorded and reported as negative accounts payable.

Including negative amounts with normal accounts payable balances distorts both the accounts payable and receivable balances. For example, in its September 30, 1986, financial report to DLA, DFSC reported its accounts payable balance to be \$416 million. However, this balance included more than \$46 million of negative balances that were netted against the normal accounts payable, thus understating both accounts payable and accounts receivable by the amount of the negative balances.

We also found that recording and reporting overpayments as negative accounts payable hinders collection efforts. For example, the Administrative Support Center officials, responsible for collecting overpayments, told us that they do not receive reports from DFSC which specifically list the negative balances and thus are unaware of the exact amount and extent of overpayments. These officials told us that, generally, they are not made aware of contractor overpayments until the contractor either (1) notifies the Support Center of an overpayment or

(2) submits an invoice for additional fuel deliveries which would require the Support Center to review the contractor's account balance.

Administrative Support Center officials told us that if neither of the above two situations occur, overpayments are not readily detected. They stated that this was evident in their recent review of negative accounts payable balances when their preliminary work found that 20 of the balances, totaling about \$1.7 million, had been outstanding for up to 120 days because the contractor had not notified the Support Center of the overpayment or submitted another invoice.

DFSC officials acknowledged that recording and reporting negative amounts as accounts payable had resulted in inaccurate financial reporting and hindered collection efforts. They told us that DLA has instructed them to change their procedures for recording and reporting negative amounts and that they are in the process of doing so. They could not tell us when they expected to comply with DLA instructions.

Need to Correct Weaknesses Before Implementing New Disbursing System

Currently, the Support Center manually processes DFSC contractors' requests for payments and relies on documentary evidence, such as receiving reports and delivery orders, to validate these payments. The Support Center, however, plans to implement an automated disbursing system which will interface with DFAMS and rely primarily on DFAMS data to validate payment information.

Prior to fully relying on the automated disbursing system, we believe the Support Center and DFSC should ensure that the internal control weaknesses discussed in this report have been corrected and that the accounts payable data in DFAMS can be relied upon for payment purposes. We believe the best approach would be to continue to operate the manual system until the new automated system, using DFAMS' data, shows that it can make reliable disbursements.

Conclusions

There are material weaknesses in DFSC's controls for recording and reporting accounts payable. As a result of these weaknesses, the account balances recorded and reported by DFAMS are not reliable. DFSC (1) cannot be sure the amounts recorded in DFAMS accurately reflect the amounts owed contractors, (2) is not able to adequately identify and recover contractor overpayments, and (3) cannot accurately report its financial condition.

Recommendations

We recommend that the Secretary of Defense direct the Defense Logistics Agency Director to require the Defense Fuel Supply Center to

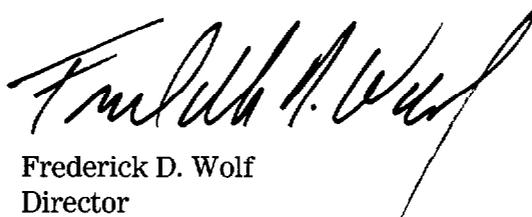
- determine why accounts payable data on price adjustments, delivery dates, and quantities delivered are not being properly recorded in and processed by DFAMS and institute controls to correct these problems;
- review the resources needed to conduct the accounts payable reviews required by DLA regulations and, if resources are adequate, begin conducting the required reviews or, if resources are not considered adequate, develop alternatives for complying with the requirements;
- classify and report negative accounts payable amounts as accounts receivable as they occur and ensure the prompt collection of these receivables.

We also recommend that the Secretary direct the Defense Logistics Agency Director to require the Administrative Support Center and Defense Fuel Supply Center to

- ensure that the accounts payable weaknesses have been corrected and that the payable information reported by DFAMS can be depended upon for payment purposes prior to fully relying on the automated disbursing system, and
- continue to operate the manual disbursing system until the automated system shows that it can make reliable disbursements.

Unless you publicly announce its contents earlier, we will not distribute copies of this report until 30 days from its date. After 30 days, we will send copies to the Director of the Office of Management and Budget, the Secretary of Defense, and the chairmen of the Senate Committee on Governmental Affairs, House and Senate Committees on Appropriations, and the House and Senate Committees on Armed Services. Copies will also be made available to others on request.

Sincerely yours,



Frederick D. Wolf
Director

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